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PACIFIC TELESIS
Group-Washington

January 27, 1993

Donna R. Searcy
Secretary
Federal Communications Commission
Mail Stop 1170
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Dear Ms Searcy:

Re: *MM Docket No. 92-266 - Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992 (Rate Regulation)*

On behalf of Pacific Telesis Group, Pacific Bell, and Nevada Bell, please find enclosed an original and six copies of their "*Comments*" in the above proceeding.

Please stamp and return the provided copy to confirm your receipt. Please contact me should you have any questions or require additional information concerning this matter.

Sincerely,

William F. Adler

Enclosures

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket 92-266
	)	
Rate Regulation	)	
	)	

COMMENTS OF PACIFIC TELESIS GROUP, PACIFIC BELL, AND NEVADA BELL

Pacific Telesis Group, Pacific Bell and Nevada Bell ("the Pacific Companies") respectfully submit the following comments on the Notice of Proposed Rulemaking in the above captioned proceeding.[1] In the NPRM, the Commission inquires as to the implementation of the 1992 Cable Act,[2] Sections 623, 602 and 622(c) concerning the regulation of rates for cable service and leased commercial access.

I. INTRODUCTION AND SUMMARY

Congress emphasizes in the 1992 Cable Act that "most cable television subscribers have no opportunity to chose between

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[1] Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, Rate Regulation, MM Docket 92-266, Notice of Proposed Rulemaking, released December 24, 1992, FCC 92-544, ("NPRM").

[2] Cable Television Consumer Protection and Competition Act, Pub. L. No. 102, §3, 106 Stat. 1460 (1992) ("1992 Cable Act").

competing cable systems."[3] That is, most cable subscribers are faced with the choice of paying the rates charged by the local cable operator or going without service. But unlike telephone service, those rates have been for the most part unregulated. Congress directed the Commission to remedy this absence of either competitive discipline or regulation. The Commission is to ensure that cable rates are "reasonable."

From their monopoly businesses, cable companies are moving into telephony, first as alternative access providers and soon perhaps to provide local exchange telephony services over their cable systems. We would like to compete -- fairly -- with cable operators both in telephony and in cable television. But, in each case, the structure of regulation must be made symmetrical. That means removing the cable cross-ownership restriction on telephone companies, as the Commission has recommended. It also means ensuring that cable operators compete fairly when they enter the telephone business.

Both of these important policy goals -- fair rates to cable consumers and fair competition between cable and telephone companies -- can be achieved by faithful adherence to Congress' directives in the 1992 Cable Act. Congress had in mind a fundamental principle in mandating reasonable cable rates: rates should be based on the costs of providing particular services plus a reasonable profit. Costs include items such as programming charges and taxes, as well as the proper share of the

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[3] 1992 Cable Act, §2(a)(2).

joint costs of a multi-use transmission system. Rates must not include any cross subsidy for non-basic or non-cable services. Cross subsidy is especially of concern when the same transmission system is used to provide multiple services. Captive customers of a basic cable service provided on a multi-use transmission system should pay only that portion of transmission costs attributable to their use. This principle not only protects the consumer but also prevents improper cross-subsidy of competitive services.

The near future promises increasingly flexible cable and telephony technologies. As service offerings converge, regulatory distinctions will become increasingly artificial and arbitrary -- especially those that treat providers of the same services differently. For true competition to occur, competitors must be on equal footing. Until the marketplace can regulate through competition, the Commission must regulate in keeping with Congress' mandate. In this proceeding that mandate is to assure that basic service rates are reasonable and that unreasonable rates for cable service are easily identified. Thus, the Commission must find a means to assure that rates only include appropriate costs. That can be done efficiently and quickly using existing cost allocation policies and procedures applied in the context of basic and nonregulated telephony services. With those rules, the Commission can assure regulations that meet the intent of Congress in requiring rate regulation.

II. DISCUSSION

1. The Act Requires The Commission To Establish Reasonable Rates

a. Congressional intent is clear.

Congress made very clear that it wished to protect consumers from excessive rates and prevent improper cross-subsidization of competitive services from monopoly cable rates. Unable itself to give detailed directions to achieve these goals, Congress directed the Commission to do so by ensuring that rates be "reasonable." The concept of reasonableness is not vague or indefinite. Congress gave the Commission guidelines.[4] Reasonable basic rates are those that meet specific criteria. They must be in line with rates charged by competitive systems. They must take into account direct programming and transmission costs. Rates should include only those portions of joint and common costs properly allocable to basic service. Taxes and franchise expenses are to be treated as costs. Advertising revenue is factored in. A reasonable profit is added. Reasonable rates equal actual cost of providing service plus a reasonable profit.

b. Reasonable rates do not include cross-subsidy.

Cable systems do not only provide basic services. Where cable systems are used for expanded basic services or non-cable

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[4] Joint Explanatory Statement of the Committee of Conference, Conference Report, Cable Television Consumer Protection and Competition Act of 1992, 102d Cong., 2d Sess., Report 102-862, ("Report"), pp. 58-66.

services, including telephony, the treatment of joint and/or common costs provides opportunity for improper cross subsidy. Congressional intent on the treatment of joint and common costs is clear. Joint and common costs are to be recovered in the rates of unregulated services, not just basic services.[5] Although the Report specifically mentions "non-basic cable services" as an example of unregulated services, Congress intends to prohibit improper cross subsidy of any service. Hence the general injunction that the "basic tier must not be permitted to serve as the base that allows for marginal pricing of unregulated services" applies.[6] "Unregulated services" here should be read broadly to include telephony services carried on a cable system -- and such a reading of congressional intent makes sense. The consumer is hurt just as much by padded basic rates if the padding is used to subsidize telephony services as if it is used to subsidize premium services or is taken as excess profit. Moreover, both in cable television and telephony markets, the allocation of joint costs helps to protect competition which further benefits consumers.

c. The Commission's regulation must prevent cross-subsidy.

An overriding goal of the Commission in establishing basic cable rates, then, must be to prevent cable companies from including costs for non-basic services in basic cable rates. The

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[5] Report, p. 63.

[6] Id.

Commission must reduce the incentives for improper cross-subsidy whatever the regulatory alternative chosen to regulate basic rates.

With respect to benchmarks, the Commission asks for comment on which variables should be used to differentiate cable systems. The Commission suggests some important variables to be taken into account including density, capacity, system age and local prices. Pacific recommends that another very important variable be added: whether the cable company provides non-cable services -- such as telephony.

To the extent that a cable company uses its transmission system to provide telephony or other non-cable services, any regulatory approach should result in cable receiving no advantage over its competitors. To permit otherwise would result in unequal and unfair regulation. The Commission requires safeguards against the potential for cross-subsidy and discrimination where a telephone company uses its facilities to provide cable video-dialtone services.[7] Even the Commission's recommendation that Congress eliminate the cross-ownership prohibition includes continued regulatory limitations on a telephone company's ability to compete in cable services.[8] Cable companies should be subject to similar restraints when seeking to provide telephony services.

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[7] Second Report and Order, Recommendation to Congress and Second Further Notice of Proposed Rulemaking, 7 FCC Rcd 5781, (1992) at paras. 79-96.

[8] Id., paras. 135-143.

After initial rates are established, the Commission could regulate subsequent rate changes using a price cap approach. An annual reduction in the relevant price cap could be included to account for productivity increases that will certainly flow from improved system technology and increasingly efficient uses of the system. A productivity factor similar to that used for telephone companies would be appropriate because improvements in cable technology can be expected to track improvements in the similar telephone technologies.

2. As Cable System Technology And Services Become More Like Telephone Systems And Services, So Should Cable Regulation

While benchmarks and price caps can provide some protection against improper cross subsidy, these methods can probably only be useful in regulating rates of a cable system if telephony or other non-cable services use is incidental. If a system is truly a jointly used system where a significant portion of the capacity of the cable system is used to provide telephony services, regulation should reflect that shared use. The likelihood of a truly joint system is high given the convergence of voice, data and video technology that will eliminate distinctions between cable systems and telephone systems. Just as it will be impossible to differentiate how a digital transmission signal will be used over the telephone network, so will it be for a cable network. And, as cable companies increasingly provide services traditionally offered by telephone companies, and vice versa, regulatory distinctions between cable and telephony will be artificial and arbitrary.

The Commission has made clear its preference for marketplace regulation. The Commission is exactly right. If competition exists between cable and telephone systems for telephony services, and when telephone companies are permitted to provide services now limited to cable companies, neither cable nor telephone systems should be regulated except by the marketplace. When there is competition, if the Commission believes that public policy requires the continued regulation of telephone systems, it must either apply similar rules to cable systems or explain why similar regulation of cable systems is not also in the public interest. For example, the Commission should explain why the same equipment used to transmit digital signals should have different depreciation lives if used by a cable or a telephone company.

Until Congress permits telephone companies to fully participate in the video programming marketplace, however, and while cable companies are permitted to provide telephony services, telephone companies should not have to compete in markets shared with competitors who operate under completely different rules -- rules that are easier and less costly to comply with.

3. Existing Regulation To Prevent Cross Subsidy In Joint-Use Systems Can Be Applied To Cable Systems

Unless competition exists for the provision of cable services, the Commission must ensure that basic rates do not include cost that cross-subsidize non-basic services. The Commission has already spent a great deal of time and effort to

ensure that telephone rates are reasonable -- that no cross-subsidy exists for non-basic services. That comprehensive regulatory structure could be applied in whole or in part to protect against cross-subsidy from basic cable service rates. Notwithstanding Congressional directive that cost allocation manuals should not be required, Congress endorsed cost allocation by directing that basic rates should only include those portions of joint and common costs properly allocable to basic services.[9] An annual audit attesting to compliance with proper cost allocation methods and periodic audits are appropriate to support a cost allocation system. These mechanisms could be one way for the Commission to fulfill its responsibility to ensure reasonable cable rates and to further fair competition between cable and telephone companies.

III. CONCLUSION

The Commission is charged with implementing regulations that promote Congressional goals of the 1992 Cable Act. Competition is the keystone of the Act. The intent to require fair competition permeates provision after provision. But for competition to occur, competitors must be on equal footing -- whether competition is among cable providers or between cable and telephone companies. The Commission's challenge is to develop regulations that provide for fair competition, thus protecting the consumer and furthering diversity of information and other

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[9] Report, p. 63.

policy goals. Fair competition requires regulatory symmetry among competitors. Ensuring that basic cable rates do not include cross-subsidy is one step along the path of regulatory parity and fully supports the statutory requirement that rates must be reasonable.

Respectfully submitted,

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